Office of Chief Counsel Internal Revenue Service memorandum date: April 15, 2002 LM:RFPH: to: from: Associate Area Counsel, (LMSB) subject: Charter Ownership Agreement Income You recently requested our advice concerning the sale of charter ownership agreements at . This memorandum responds to your request. This memorandum should not be cited as precedent. For the reasons described must report as income below, we agree that the the amounts received from the sale of the charter ownership agreements. <u>Issues</u> 1. Must the recognize income from the sale of charter ownership agreements at 2. How much income must the recognize? Conclusions 1. The must recognize income from the sale of charter ownership agreements. 2. For the year ended February 28, ..., the must recognize \$ ____ under the accrual method of accounting. Audit Background A notice of deficiency will be issued for the shareholders of the for the year ended February 28, today, April 15, . The) is an S Corporation. The statute of limitations for the tax return already expired, however all the shareholders

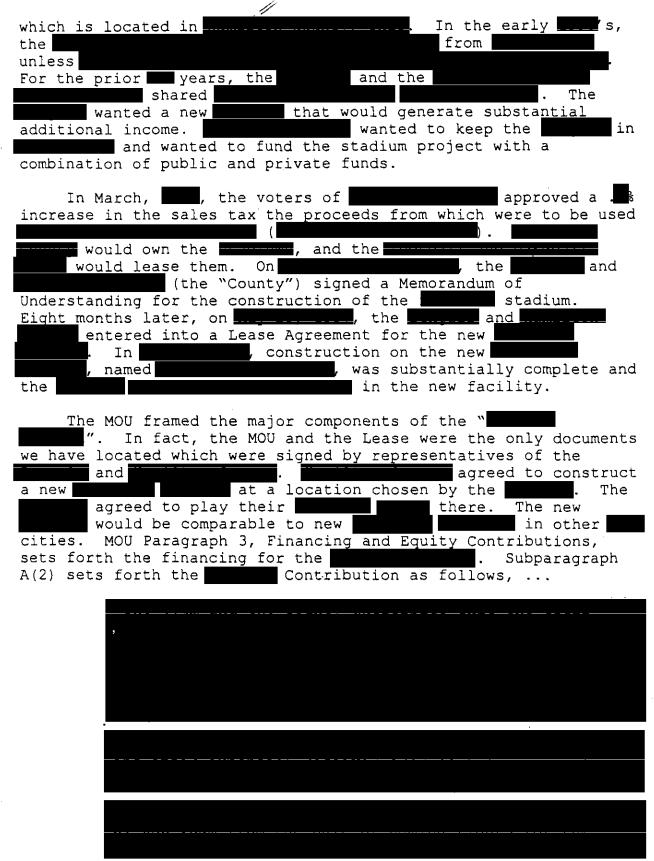
still have open statutes. The statute of limitations on assessment of an S corporation shareholder's tax liability begins to run when the shareholder's tax return is filed. S.B. Bufferd 93-1 USTC ¶ 50,038. The have not elected TEFRA audit procedures. The have not elected TEFRA audit shareholders, and shareholders, and shareholders, and shareholders, and shareholders. All these taxpayers report their distributive share of the state of the sective individual tax returns for the year ended December 31, you have determined that all of these individual statutes will expire on April 15, sections.

Earlier this year, you requested statute extensions for these shareholders. You were recently informed that the shareholders would not extend their statutes. The generally stonewalled your information requests. You summonsed information from a bank, the , and requested information from and , the county in which is located. The bank provided the information on The ____, through its attorneys, provided sparse The refused to information on provide much of the information explaining that it was privileged. has agreed to provide the information, but has not yet located the informally requested files. Last week, you met with and his accounting assistant. They identified their sales report for the COA sales and assured you of their accuracy. This issue was discovered late in the examination, the 'shareholders have increased the pressure by not extending the statute, and you are putting the notice of deficiency together at the last minute.

We are conditionally approving issuing the notice of deficiency because of the foregoing events and because we anticipate receiving additional information from .

That additional information will support the tax computation. We recognize the hazards present in approving a notice of deficiency under these circumstances. However, we also realize that if we do not approve the notice for this year, the proving a notice of their shareholders, would likely escape taxation on a substantial amount of income. Furthermore,

Factual Background



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	Paragraph of the MOU lists the coccur before the project would commence. These conditions were a) , b) , c) , d) , e) , e) , e) , and g) , states that "	must
	Ultimately, the parties negotiated an arrangement who not the parties, would be responsible for selling the plicenses. The process never physically in the funds from the sale of plicenses, frequently called or COAs (charter ownership agreements). The place of the COAs, but all assisted and cooperated with the sale of the COAs, but all revenue (net of commissions, fees, taxes, and other expensions) went first to an escrow account, a lockbox, and ultimately contains the same of the coarse	ceceived ed
	Other aspects of the sale of the licenses were a negotiated by the parties. On entered into an agreement with ("" to act as an agent to market a Licenses for to act as an agent to market with the provision of the MOU	Inc. and sell
	On and the entered in	to an
	On, and the entered in Information Access Agreement.	co an ·

additional

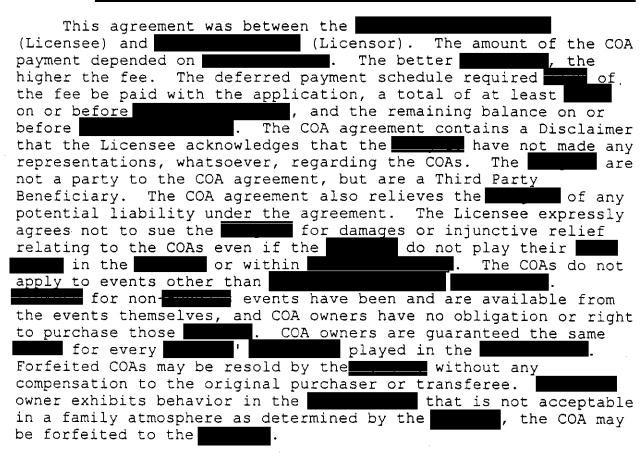
COA fee.

The also granted to a non-exclusive license to use of the " " trademark (the "Mark"). license to use the Mark expired in Shortly after the agreements, started a marketing program called " sell COAs. A or COA is a one-time fee paid for the right to buy for as long as the plays in a specific facility). The COA is transferable by the owner. The COA concept evolved as a way for to participate, at least financially, in the building or revival of their own and . Usually, substantial portions of the proceeds from the sale of go to the construction costs of a new facility. The concept has been used for all levels of facilities, including ____, ___, . The can be found in nearly every The COA program was marketed to as their opportunity to "existing were given incentives to purchase COAs. The incentives included a discount on the cost of the . These incentives required COA and priority in to maintain the until the opening of the new stadium. Current also given the right to purchase before the general public and receive priority Current . Current could also purchase an unlimited number of and maintain the discount and priority incentives for their

The Charter Ownership Agreement for provides that ...

did not share in any of the

premiums or revenues, it received only the



The COA fees were as follows:



The funds received from the sales of the COAs by, Inc., dba, were sent directly to a lockbox at
bank accounts. According to , all records pertaining to the COA program were turned
over to at the end of the sales campaign. We requested these documents but have not yet received them.
Ultimately, received and retained all net revenues from the sale of COAs prior to construction costs. An amendment to the lease dated the rights to administer the COA program and receive the proceeds of such COA sales made after the computers. The also took over the marketing program. The then obtained the right to sell and retain all revenues from sales of COAs after the computers, software, and associated licenses for the COA campaign. The COA agreement the used beginning in the year when the began selling the COAs is substantially similar to the agreement used
In, we interviewed, Administrator
for, to discuss the MOU and Lease Agreement was a somewhat reluctant witness who appeared helpful to the An attorney from was present at the interview as well as the ' attorney, whom
interview as well as the 'attorney, whom 'invited'.

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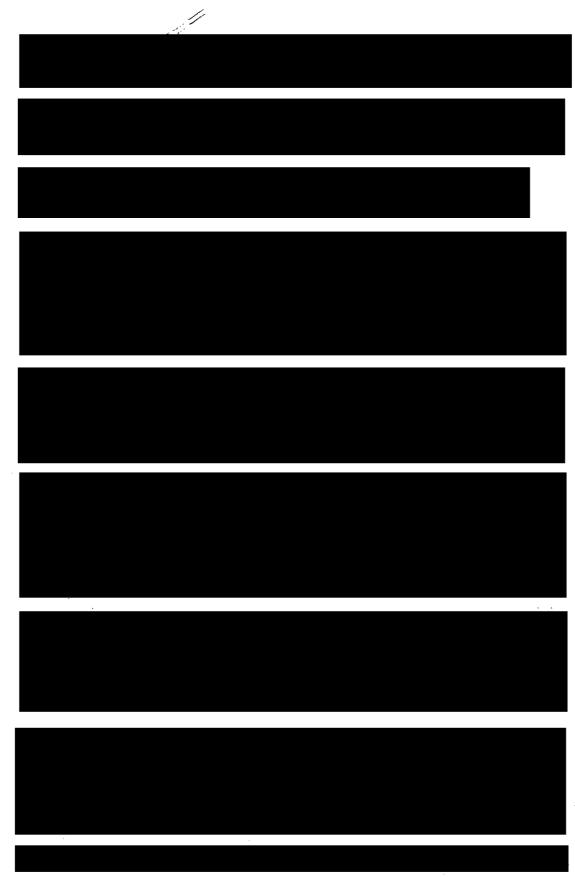
At the time of these events, the declared that they were . The publicly stated that they contributed to the construction of the the declared that they contributed to the construction of the the declared that they contributed to the construction of the the declared that they were . The declared that they were the declared that they wer

The VTS Waiver

apparently was unaware of or otherwise for	got
that the and the believe they have rights to	
revenues. Concurrent with the Lease agreement,	
,	

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CC:LM:HMT: :1:POSTF-164607-01 page 10 The requires certain types of revenue be shared among all the teams. Visiting teams get approximately \$\bigcup_{\text{\color}}\end{aligned}\$ of these sources of revenues after the games are played. . The estimated sales was \$ for years. The were \$ computed by taking the total lease payments to be made by the of \$1000 and other up-front payments of \$1000 These other up-front payments of \$ _____ appear to correspond to the \$ ____ in and the \$ per surcharge that were listed as components of the contribution to the _____ in the MOU of . The estimated the Total Waiver with (\$ for and \$ Request to be \$ for The Lawsuit Some did not receive COAs in . Apparently, COAs in the more These sued and the

A settlement of the case was entered on

provided

Apparently,

these

purchasers while the

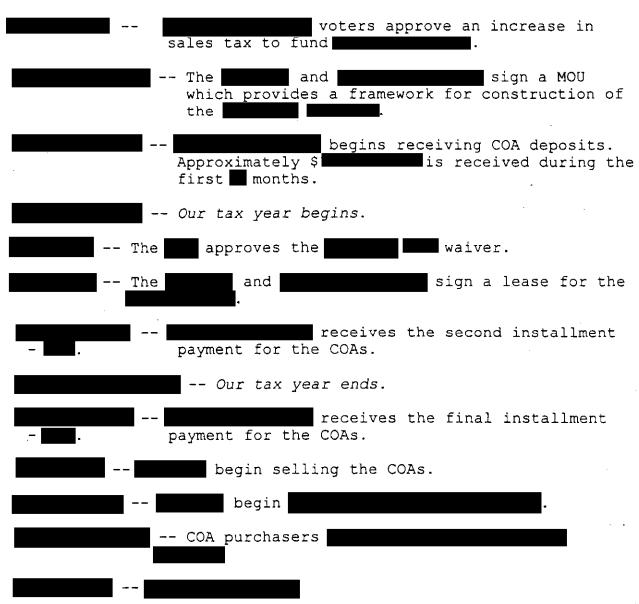
refunded some money to the COA

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for

The Timeline

A time line might help understand the foregoing events.



Analysis Is It Income to the

We believe the COA funds are income to the based upon well settled principles of income taxation. While the negotiated the transaction so that it would not actually possess the funds, the funds are nevertheless income to the Section 61 of the Internal Revenue Code generally defines gross income as "income from whatever source derived",

except as otherwise provided by law. Gross income includes income realized in any form, whether in money, property, or services. This definition encompasses all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). Income must be taxed to him who earns it. Commissioner v. Culbertson 337 U.S. 733 (1949).

Section 61 does not determine who is responsible for the tax liability once sums have been identified as income. Generally, the taxpayer who receives the income is taxable on it. However, some sharp taxpayers structure income producing arrangements so that they do not actually receive the income even though they earned the income or otherwise had a right to it. These sharp taxpayers place receipt of the income in a taxpayer who has little or no tax liability or is otherwise indifferent. The negotiated an arrangement which places the income in the hands of a governmental entity — To address this abuse, the Courts have developed the assignment of income doctrine. This doctrine is designed to prevent taxpayers from shifting income to avoid paying federal income taxes. Lucas v. Earl, 281 U.S. 111 (1930); Corliss v. Bowers, 281 U.S. 376 (1930).

In <u>Helvering v. Horst</u>, 311 U.S. 112 (1940), the taxpayer detached interest coupons from bonds, just prior to their due date, and gave them to his son. Although the son collected the interest at maturity, the Commissioner determined that these interest payments were income to the father. The Court held that the father's control and enjoyment of the income sufficed to establish him as the recipient of the income. As holder of the bond and coupons, the father had the legal right to demand payment of the interest at maturity. The Court recognized, as it had in <u>Corliss</u>, that the power to command disposal of income was tantamount to enjoyment of that income.

Our research reveals no case with substantially similar facts as our own. Apparently, all the other situations were resolved without a Court opinion. While there are competing theories for income recognition in this case, e.g., constructive receipt, agency theory, we also believe our best argument involves an assignment of income theory.

The are an accrual method taxpayer. Section 451(a) of the Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, the amount is to be properly accounted for in a different period. Treas. Reg.

§ 1.451-1 provides that, under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive the income, and the amount thereof can be determined with reasonable accuracy. All the events that fix the right to receive income occur when (1) the required performance takes place; (2) payment is due; or (3) payment is made, whichever happens first. See Schlude v. Commissioner, 372 U.S. 128 (1963), 1963-1 C.B. 99; Rev. Rul. 80-308, 1980-2 C.B. 162; Rev. Rul. 79-195, 1979-1 C.B. 177.

In <u>San Francisco Stevedoring Co.</u>, 8 T.C. 222, 225, the Tax Court set forth the principles of law applicable to a determination of the proper accrual of income as follows: A taxpayer, using an accrual method of accounting, must accrue an item in the year in which the taxpayer acquires a fixed and unconditional right to receive the amount, even though actual payment is to be deferred. There must be no contingency or unreasonable uncertainty qualifying the payment or receipt. Income does not accrue to a taxpayer using an accrual method until there arises in him a fixed or unconditional right to receive it.

Income in Which Year?

We have chosen to adjust the property income for the year

ended, primarily because during that fiscal
ended , primarily because during that fiscal year the and and signed the Lease Agreement.
While the COA sales program began in late, substantial
contingencies in the project existed until the lease was signed
on . Until all conditions precedent were met, there
was a possibility would not be constructed and the
COA deposits would be refunded.
The MOU of , set out the proposal for the
project including financing. The MOU specifically stated
. The \$ was to be
comprised of net revenue from the sale of licenses, a
portion of the per , lease payments and \$
. With the exception of the yearly rent payments, none
of the other items required an outlay of cash from the
Even though the sale of the COAs did not require an outlay of
cash from the would have not been able .
to sell COAs without the allowing them to sell them.
Before the could enter into the lease with
, they had to obtain permission from the . The gave
that permission in, a date within the's

fiscal year. The indirectly approved the MOU with this

resolution. The obtained the necessary waiver for nonsharing of the COA income and teams during our year. It is no coincidence that these granted waivers and other items coincide with the amount of the contribution due from the under the MOU.

How much Income in Our Year?

We note that for the who subscribed to the original COA agreement, payments for the COAs were made over a year period:

; and Most of the COA purchasers used this deferred payment option. Some however, paid for the COAs in 1 lump sum payment. When we identified those amounts, we eliminated the "lump-sum" purchases made after Those purchases are income to the in later years. For lump sum payments made in a prior year, we still believe that year for reporting the income because that is the year the lease was signed.

While we must issue the notice of deficiency for the 'year ended', at this time, we have additional time to issue a notice of deficiency for the subsequent years. If we have included this income in the wrong year, we can fix that. This is the only issue on the current notice of deficiency. Because the did not include the income from the COA sales, the did not seek to write off any expense or amortize any asset when the funds were turned over to the determine the appropriate write off of these amounts by the

Conclusion

The proceeds from the sale of the Charter Ownership
Agreements (COAs) are taxable income to the in the fiscal
year ended Theassigned their right
to receive this income to as their contribution
for the lease of as stated in a Memorandum of
Understanding (MOU) dated used . The
the accrual method of accounting to recognize income and
expenses. In accordance with IRC §451, the COA income would not
have been accruable by the in fiscal year ended
, because their right to the income was not fixed due to
contingencies. When the signed the lease in grown,
the majority of the conditions had been satisfied. Therefore,
the 's right to the income accrued during the year ended

If you have any questions about this memo, please contact at . A copy of this memorandum will be sent to our national office for a 10 day post review.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Associate Area Counsel (LMSB)

Ву:____

Senior Attorney (LMSB)